Symposium: Regulatory Capture and Technological Entrepreneurship: Protecting Consumer Interests?

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PEPPERDINE UNIVERSITY
SCHOOL OF LAW

JOURNAL OF BUSINESS,
ENTREPRENEURSHIP, AND THE LAW

WITH, THE GEOFFREY H. PALMER
CENTER FOR ENTREPRENEURSHIP
AND THE LAW

SPRING 2015 SYMPOSIUM:
REGULATORY CAPTURE AND
TECHNOLOGICAL
ENTREPRENEURSHIP: PROTECTING
CONSUMER INTERESTS?

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Great. Thank you. So, my name is Robert Anderson. I am a professor here, and I am the faculty director of the Geoffrey H. Palmer Center for Entrepreneurship and the Law. I would like to—for those of you sort of filtering in and out—I would like to encourage you, you know, come in and out as you are able. We know that this overlaps somewhat imperfectly with the 1L class schedule, so, if you need to go, need to have other people come back in, that is fine. Do not feel that you are interrupting anything. And, also, I do not think any of us here are planning to give an hour-long speech, so we want—

Babbette Boliek

Speak for yourself, Anderson. [laughter]

Anderson

So, we want this to be a collaborative discussion, because many of the technologies and things that we are going to be talking about, our students are going to have more actual familiarity with than our faculty and our experts. I am only speaking for myself here, but that is certainly the case for me. So, what we look at is for the broad overviews and trends and “Here is where we came from, and why we are here, and here is where we are going,” but you know a lot of times someone like me, I try to stay up to date, but I often times, I do not use emerging technologies the same way that law students do, for sure. So, I learn from them a lot. So, I hope that you will just feel free to jump in and participate at any time. So, sitting at my left is Professor Boliek.
Boliek

Well-pronounced. [laughter] I am Professor Boliek. Hi! This is mostly my students, so . . . [laughter] . . . so, I am going to tell them the truth about Anderson. [laughter] So, you know my background. I have, as well as a law degree—I actually do have a law degree, I know many people question that, after they have been taught by me especially [laughter]—but, I also have a PhD in economics, and my background, both by education and by practice, has been with telecommunications and the telecommunications industry, including broadband access and everything that has to do with over-the-top applications, which I know my students know very well and use liberally during class, which I cannot fault them for that, because it is my specialty. So, I will be, to the extent that our conversation goes that way, talking about different things in telecommunications or the past history of the relationship of the regulator to this industry, which has a very long storied past and a very deep and complicated future, as well as looking forward to speaking about industries of which I know nothing, so, of course, I will talk the most about that. [laughter]

John G. Shearer

I am John Shearer. I am here with the Grazidio School, and I have an interesting role as part of the entrepreneurship program there. I am their entrepreneur in residence. That is the title we gave it, but what I actually do is that, as the students and alumni are coming up with business ideas, and as they are going through the process of finding out, “Okay, is this a valid problem that needs to be solved? Is there a real value to the market? Okay, how do you create this solution?” and, if it requires the technology, my job is to go find the technology and if it already exists. Either national labs, international labs, we have got a network of sources. It is kind of fun. I actually call it—I am the “dumpster diver.” The way it works is, “Hey, you have got this thing on the shelf, at this government lab. I think I can use it to solve this problem and license it.” An example is that we just launched a company last year called Champion Technologies, and I am the CEO of it right now. And, it is in cyber security. It was being used internally by the government for nuclear non-proliferation and tracking everything—from the mine, to the yellow cake, all the way through to, “Hey this stuff exists, where is it going?” So, we took that core code and turned it into a cyber security app, which we launched last week, and it is being tested by the government now for sixty days, then it will hit the commercial market. Really cool stuff. Background, I have actually had run-ins with the FCC with some technology that I invented myself, had some interesting things—I have got some real war stories that I will bring to the table. So, if you are ever thinking of starting a business, and it needs a technology, you get my contact info. I am really good at dumpster diving. I will find it for you. [laughter]
Christopher Koopman

I am Chris Koopman, and I am a research fellow at the Mercatus Center at George Mason University. I work on our Project for the Study of American Capitalism, so, essentially, what I do is I do a lot of research on the intersection of regulation, innovation, and competition, especially in the context of the sharing economy—so things like Uber, Lyft, AirBNB, Feastly, and all these cool things that are popping up right now, and also stuff like Tesla: a lot of public choice research on regulatory capture and the uses and misuses of regulation to protect certain incumbent firms or industries at the expense of consumer welfare and competition.

Anderson

Great. Well, our first panel is focused on Tesla: “What Tesla’s Taught Us: Are State Reactions to Tesla’s Product and Consumer Model in Consumer’s Best Interests, or Regulatory Capture and Protectionism.” So, living in Malibu, you probably see a lot more Teslas than the average person in, you know, Akron. So, we know what they are, but does somebody out there in the audience—who was not part of organizing this—know what Tesla’s regulatory problem is, anyone know? Yeah. [inaudible response from audience] So, yeah, trying to sell directly to consumers, cut out the middleman, thereby reduce the price, increase profit, control their own network better than if they are working through a network of dealers that you constantly see advertising on TV. And, believe it or not, many states will not let you do that. And, the question of why, I will just present the two basic sides, so that we can dive into the weeds a little bit more. What they say is that the reason that the dealer model is mandated is to protect consumers against automobile manufacturers who would essentially otherwise not compete with one another about having all of the zillions of dealers out there advertising their sales and having giant balloons and whatever and people dressed in monkey suits and stuff jumping around to get you to come into the dealership that would somehow simulate competition. The other side, of course, you say, “All of this stuff is expensive.” And, we do not really need it. Why cannot a company like Tesla just sell cars directly on the Internet to people who just want to buy them, who already know what they need to know about it, who do not really need to test drive, or they can bring one to you for a test drive. Why cannot that model be at least one of the ones that is available for consumers to look at? Maybe consumers would reject it, maybe consumers would say, “I do like going into the dealer. I trust them. They are trustworthy.” I do not know. So, with that, let us turn this particular issue over to our panelists. We will just go in the same order, starting with Professor Boliek, to make some comments.
And, I am going to flip it over to the person who has actually worked on that. So, go in reverse order. [laughter]

Okay. So, I guess I would start with, with every regulation you have to figure out what is the market failure they are trying to correct. So, in this case, what is their theory of regulation? Why are they mandating franchise laws? So, this is a relatively new phenomenon. It did not start initially with the advent of car sales. It actually started in the 1960s. A lot of states started mandating franchise laws, which include relevant market areas, so you know two dealers cannot be too close to one another, and actually protected them from competition. So, if one GM dealer is here, then GM cannot put another dealer or sign an agreement with another dealer somewhere else within a certain boundary. And, a lot of this, I guess in my opinion, has nothing to do with consumer protection, but a lot of it is competitor protection. So, this is essentially giving the dealers an opportunity to recoup their investments and to protect them from, I guess, the idea that the dealers are on sort of an uneven basis with the manufacturers. So, somehow, a dealer is not strong enough to contract with a manufacturer on terms that are in the dealer’s best interest. So, essentially, states stepped in and implemented these laws in a way to protect dealers from the manufacturers. But, I would note just a couple of things before I turn it back to the others, is that the idea that this is somehow protecting consumers, if you look at the data—So, the FTC in the 1980s really started advocating against franchise laws in relevant market areas—the RMA sort of provisions of these franchise laws in a lot of states. And, one thing they found that was sort of striking is almost a 7.5% increase in price as a result of franchise laws. So, actually, when people were buying cars, they are more expensive because of sort of the regulatory protections the dealers get. Now, this was in 1986, or something. They were looking at statistics from the early 1980s, and they found something like $3.2 billion in terms of increased price. So, this is all dead weight loss. These are all things that could have gone to other more productive uses—essentially, a direct transfer from car buyers to the dealers as a direct result of these sorts of regulations. I guess one final note before I turn it over to these guys is that just to think about it more in the abstract, do you have a better—I guess I will just pose the question to you guys—do you guys have a better experience buying your computer, your Apple computer, from the Apple store, or when you buy it from Best Buy? So, the entire sort of business model of Tesla is the sort of direct distribution model that Apple uses. And, I think people are extremely satisfied with this, so much so that Microsoft, which had never tried to sell direct to consumers before, started their own Microsoft stores to compete. So, in a lot of ways, I think that in other industries consumers are much better off when they are buying directly
from the manufacturer, and I see no reason why, I guess, cars would be any different.

Shearer

Well, my life has always been finding disruptive technologies and disrupting business models. I mean that is what I do. So, when I look at the issue, in the world that I am in, the regulations are usually a barrier to anything innovative, whether it is a business model or a technology. And, the incumbents really do not want the disruption. One of the things that I have made major mistakes in, and Tesla is probably a good example, is where you forget that, if you are going into the market, the customer wants to buy. I mean why would they not want it? They actually want it. And, then all of a sudden, you cannot sell it, because of something that is impeding you from getting there. So, that is where my, just for the panel, where my mindset is going to come from, and, just in general, would you rather have, if you are able to—if you won the lottery tomorrow or actually have the cash—would you rather buy directly from Tesla or go through a middleman? How many would rather buy direct? [hands raised in audience] Elon Musk would be really happy if he were here. Yeah, because what are they really supplying? Especially, with a new technology, whoever created it are going to be the only ones who have the expertise to service it if there really is an issue. So, how do you train service technicians to work on a new innovation? That is a reality to bring something to market.

Ross Coker [from audience]

Since you mentioned your expertise with these disruptive technologies, do you think you can talk about the flipside of that, how the fact that it is a disruptive technology might, to some, justify it being part of a regulatory scheme, as opposed to sort of letting it burst on the market?

Shearer

Well, I will use an example, a real one with the FCC. A technology that some others and I invented, and have some patents for, is in the area of wireless power. So, that puts you directly in the sights of the FCC, when you are using spectrum for a purpose that was never thought of, because spectrum is used for sending content in the form of video, audio, information, and data. That was its purpose. So, then you look at this. So, now here is spectrum, and the way that that information and content moves is through a radio wave. So, they call it a carrier. So, we come in, and we say, “Wait, I want to use that carrier wave as a way to move energy.” Because, it is energy. So, putting it in perspective, when TV stations went to digital, that was great, but then they pumped up the volume, meaning those transmitters that were out there were usually 1
million Watts or so, and now they are going to 10 million Watts, blasting out the energy to get that digital signal to the four people that are still using an antenna. So, our approach was “Can we harvest that energy like a solar and convert it back into power and power low-power sensors and LEDs?” A lot of it would just transmit on purpose. So, that is where things got interesting. So, that is a disruptive technology. We did this twelve years ago and in a super efficient way. And, it is really hard to get to the market. People wanted it of course, but it is now just starting to hit the market, fourteen years after it was absolutely proven that the product was ready. And, it was because of regulation. But, it is actually—what is interesting is that we actually fit in all the current regulations, but the incumbents actually created falsified documents and stuff and fed it to the FCC. That delayed us. It is interesting. It is crazy stuff. I do not want to get into the details of that, but I do want to—

Boliek

Oh, I do. [laughter]

Shearer

Oh, you can never prove it. I had the chief of the FCC tell me, “Mr. Shearer, you have some very powerful enemies,” because they had been duped. The FCC came after me, but all the documents they had, they were falsified. They were like fake magazines and stuff. It is crazy. They said things, but you can never prove it. So, that is just an example of how the incumbents, and I think this exact thing is going on with Tesla, it is the incumbents. Their competitors will do anything to protect their dealers, so that that product, it is harder for that product to get to the market. That is the reality. That is nothing about consumer. Nothing. That is, God forbid, it is free markets, but that is the dynamic. I think, personally I am like “Wow.” Things are moving fast. Regulations cannot keep up with the reality of what they are supposed to be doing.

[question from audience]

Suggesting that you think the bigger pushback is not from the dealers, who are losing out on being the middleman, but it is more from the other manufacturers protecting their dealers? Is that what you are describing?

Shearer

Well, I look at them as one entity, in my view. They are part of the same vertically integrated delivery system. That protects it and dealers. Dealers do not make much money off selling a car. It is nothing to do with that. I think it is something like 6% of their profit is from selling cars. It is all from service.
I heard that number last week. Someone asked me, “Do you know what the real number is?” I guessed 5%, and she was like “Wow, how did you know that, six.” I just knew that, but I do not know if I can back that number up. But, it makes sense that all their money comes off service, and what if you have a car that does not need much service? Kind of messes your business model up.

Koopman

And, I would add to that. So, part of these franchise laws actually are dictating the contractual relationship between dealers and manufacturers, in servicing. So, a lot of these laws actually say a dealer sets the rates for servicing, especially when it is warranty, as opposed to when you just drive your car in and say, “I need four new tires.” It is when you bring your car in, and it is still covered by the 100,000 mile or whatever the manufacturer’s warranty is. A lot of these laws actually give a lot of power to the dealers in terms of dictating how they are paid, versus competing with one another to actually get paid in terms of market rates.

Shearer

So, is that why when they charge me for an hour and a half of work, because that is what the book says, and it only took them ten minutes?

Koopman

Probably. I am not—I do not know the exact—

Shearer

But, that is how they do it.

Koopman

And, a lot of this is—[inaudible]

Shearer

To change a tire takes this much time, no matter how much time it takes, no matter who you are, according to that. So, that is what you charge, and that is the only way you can do it and negotiate off of that.

[inaudible question from audience]
Shearer

I will let someone else take this because, honestly, it makes me mad.

Boliek

Well, just to back up a little bit, I want to be perfectly clear what we are talking about with franchise laws, and I want to be perfectly clear that I know what we are talking about with franchise laws. You are talking about the actual statute forbidding direct sales. Now, let us not confuse that with freedom of contract, where people can have franchises when they see that is the most efficient model for them. Now, franchises themselves can be, are potentially liable for what are called antitrust violations. So, sort of the things that Christopher was talking about, about using this business model as a way to collude among, but for the statute, antitrust law, if it was a private contract, would come in and take care of that. It is because it is the statute that it is not arguably going to fall under its own weight, and I think, if I am not misinterpreting, is that is both Christopher and John’s argument, that because it is in government, uh, it does have this process by which it will sustain a failing business model, by the virtue of the law. Now, the reason it got to be in the law is actually probably a pretty interesting story. It is going to be a lot of what you already talked about. It is going to be the interest, clearly of the salesmen, of the middlemen, and them as a power broker. It is going to be the manufacturers themselves, who might really like that this model is set up by all their fellow competitors as well, because there is opportunity for them to collude or not compete as aggressively. It is easier for them not to have to do it on every front, because that is expensive, to compete. So there might be reasons why they would agree to that as well. But once it is in the law, then you do not have this market, you do not allow disruption to disrupt. And that is what we’re seeing in Uber, that is what we’re seeing in other places, that are coming alongside of the law, and the people who have been basically protected by the law are now throwing stones and trying to protect often what is sort of a government-protected monopoly or “free” zone, where they do not have to aggressively compete. In exchange for that, they will often, in exchange for that sort of monopoly space, if you will—I do not want to over-use that word. I think it is grotesquely overused, but for that sort of like competition free zone that they get, they will sometimes give things back to the government. They will build a park, or have a school program, or ensure that so many people will get jobs. Things like that. So you are right. What it does is disrupt the natural process and makes a great deal more latency to change it, as you yourself have seen over the fourteen years production. Is that responsive at all? Probably not. [laughter]
Koopman

Just to add to that, so in 2008, the “big four” auto makers, let’s say three not four, essentially were failed, were propped up by the government with the bailout. Ford, I do not think, received bailout money. GM, I think did, and in GM’s case, they actually, part of the agreement with the federal government was to present a plan of profitability. So now that the U.S. taxpayer is the chief investor in GM, they are like, “Make yourselves profitable.” Because now, you know, we have a huge stake in this. And GM came back, and part of their plan was actually to cut dealers. They said it would actually be profitable for us to cut the number of dealers and to implement more of a demand-based production system. So, they are not actually going to produce cars just to put them on lots, but to actually produce cars as they were being requested. And the dealers, I mean, all politics are local, right? So the dealers are really strong locally, and I think like you mentioned, the number of little league baseball teams that have so-and-so dealer written on their chest, you know, they sponsor the little league baseball teams, but essentially, they sort of charged Congress, and Congress actually passed a resolution that said you can be profitable and you can implement your profitability plan, but you cannot cut dealers. So even GM said it is profitable for us to cut dealers, and Congress told them “No, you cannot cut dealers, because they are big contributors. They are big members of the local community, and it is in our best interest to keep them happy, even if it makes you a worse investment for the U.S. Taxpayer.” And ultimately, makes consumers and the market worse off.

[From audience]

So my question is, why is this so revolutionary when this is how the airplane industry works? For instance, we do not just produce random airplanes. I realize the industry is smaller, but like all of the things you are describing are like Boeing, who sends out a Boeing salesperson to sell planes to different companies and different airlines. So, I do not see why you cannot apply a lot of that to the car industry.

Shearer

I am probably going to oversimplify, because I do not really know why except that from a regulation standpoint—we use the term regulatory, talk about franchise law, and how it is built in to the dealer-manufacturer structure. One of the things that is extremely important for the consumer side that is in regulations all about the health and safety. In any type of vehicle, whether it is an airplane, a jet, or whatever, a car. If you’ve ever been in a Tesla, sometimes that is a jet. [Laughter] That is the commonality for where regulation is really, really necessary. I think if you can pull out from like the airplane industry, it is like all
about the regulations of building these things, and making sure that they are safe. And the cars have the same exact thing. Now, to me, just to simplify how I look at it, well make sure you have the strongest regulations when it comes to the health and safety stuff for these vehicles, that should be the common regulation. How you sell it, how it gets to the customer, has nothing to do with what the consumer needs. So the common thing is protecting them.

[inaudible question from audience]

Shearer

Well how long did it take when you buy online—did it take for the state to actually tax your purchase? So there is a fix. Disruption is not like a unitary thing; it disrupts everything, and you just brought up a whole other data point. It is like yeah, if that vehicle is going to be in that area, and that is where the owner is, traditionally it is a revenue stream, you cannot ignore it, but just take care of it.

[inaudible question from audience]

Anderson

Well I think, I mean, I see what you are saying, that does exist, it is obviously, it is more than that, because if that is all it was, that would be fine, some people can use Uber, some people can ride in a traditional taxi, and some people—if you like walking into a car dealership, and, being attacked by five different people, then you can do that—some people are flattered when people pay attention to them. So, if you’d rather just sit there online and build your car in the privacy of your own home, then you can do that and it would be fine. It is, I think it is relatively clear, as is the example with the local tax of the dealer’s provides, that there are entrenched interests, the people who have the dealerships, the people who rely on the tax revenue that they provide and so forth, and there is no getting around these growing pains. Sometimes sources of revenue for cities and for localities go away because they are no longer, they no longer serve the interests of consumers, but these special interests fight tooth and nail to stop these things from being changed. So I do not really think it is generational in the sense that the lawmakers are saying, “Oh I do not really get this Uber thing, let’s outlaw it.” I do not think that is what’s going on, I think they do realize how much of a threat it is, and the same thing with Tesla and others, and that is why they want to stop it. Because there are strong interests, you know, I wouldn’t say bribing, but “encouraging” them to do that. So I do not think it is just that your dad says, “Hey I do not get this Uber thing, and anything I do not understand should be illegal.” I think it is that he may say “I do not get this Uber thing,” but if your Dad were a politician, he would say, “Where’s my political
campaign funds coming from.” Well it is coming from dealers, Tesla’s not going to buy out the whole legislature right—in every state.

\[\text{From audience}\]

So, is it all about tax? I am hearing the commonalities; it is all about taxes and votes.

\textit{Anderson}

Well, I mean, taxes are what fund the government, and votes are what choose who’s in it, so, it is pretty—campaign contributions—it is pretty important. It is possible that you could do a study and find that actually the dealer network system does provide consumer advantages that are underappreciated. I do not know the answer to that, but what I do know is that to people like most of you, it just seems “weird” when you’ve never bought a car before, and then you think “oh, I am going to buy a Ford Focus” or whatever. Maybe I can save money buy just calling up Ford directly instead of going down to the local dealer that has this huge lot with these cars, and blow-up balloons and things.” But you literally aren’t allowed to do that. And you say to yourself, “That is weird, why would there actually be a law that says that I cannot just call up Ford and order a car. That is who makes it.” And I think more and more younger generations are starting to not accept things that my generation that just accepts as being the way it is. People like you say, “Wait a minute, why cannot I just call Ford and buy a car? Why cannot I call Tesla and buy a car from them if I do not care about the dealer experience?” And more and more these sort of grass-roots efforts are pushing back on the sort of what I’ll call the “old boy and girl” network, where politicians are captured, and the regulatory agencies are captured, and there is these networks of strong entrenched interests, because now a lot of these upstart companies are things that—forgive me for saying so—a naïve kid in their twenties said, “Well why cannot we just do it differently from what all these people are doing,” and now is a billionaire, because no one else was naïve enough or daring enough to say “Well why do not I just do this thing that is probably illegal?”

\textit{Boliek}

Wait, wait, I need to respond. Let me put the old boy out of his misery for a second. [Laughter] Speaking again to Anthony [audience member] you had a very interesting way of putting up the proposition that basically “my father just didn’t get it,” and maybe they do not understand technology. You know what I would caution your generation: You do not understand business. And I mean that incredibly seriously. And for talking about grass-roots and upending everything, let me tell you that this generation is running as fast as it can to
make sure that there is as much regulatory capture as possible. I am speaking from the trenches of net neutrality. So this generation does not understand how business work, what the motivations are, and one of the business motivations of business is not to compete—because it is expensive. Competition is not good for competitors. Competition is good for consumers. That is just the end of it. Once you start facing competition, things go down, so you know what you do? You get the regulator to stop that process. And believe it or not, we have just seen that happen in the internet, in ways that these little Tumblr guys go up and they go: “A monopoly, well uh, uh” watch the tape, it is hysterical—I am literally quoting. So they really do not understand, and that is the benefit, actually, of the Internet economy, which we will be walking into full strength. The benefit is the people who have used it, the application, the whole benefit that everyone talks about it being sort of “open internet” and all these code words and everything is you do not have to understand how it works. You can just call up GoDaddy, and they will put it on the carrier with their contracts, which they understand and they are going through. And they will get it, so you do not have to understand. So when you hear these Silicon Valley people talking, either they know very well what’s going on, and are trying to make sure that their costs are as low as possible, because contracts that have been in place for twenty, thirty years, they suddenly see a possibility to get rid of, because that was money going out of their pocket. So, the same things that we have seen for literally a hundred years—it is not new-fangled, it is very old. We have seen example and example in the FCC—it is a good one, because it is so old, of regulatory capture, and using a stick to beat up your competitor, as opposed to having to be on the open field. So as disruptive as the technology is, and the changing of the demand, the business incentives of trying to use government to sort of foreclose this “nuisance, and uncertainty, and potential risk,” which is competition, is alive and well. And that is a constant, which maybe your father could even point out to you as well.

Koopman

Just to add to this, economist Bruce Yandle at Clemson University has this interesting—I think he wrote about it in the late eighties—it makes sense, he calls it the “Bootlegger and Baptist” theory of regulation. He uses the context of Sunday liquor laws, so “blue laws.” You have the Baptists on one side, or any—that is just the denomination he used, it could be any moral, or sort of high-minded—

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8 Referencing the blogging and social media website Tumblr.com.
9 Referencing web hosting service GoDaddy.com.
10 See http://www.clemson.edu/capitalism/faculty/yandle.html.
Boliek

Church of Christ, here. Church of Christ. [laughter]

Koopman

And they provide the moral justifications for regulations. For example, they say: “Think of the children. We have got all of these reasons that we have to protect people, and we have to keep them safe from all of these dangers,” while at the same time you have the bootleggers that say: “Well if you ban Sunday liquor laws [sales], all of those guys who you think will be going to church (or girls) are actually going to be coming to the bootleggers to buy their alcohol, at a higher price than they would if they were going to the store, we can charge a premium because there is decreased competition.” So you see this coming up everywhere, even in net neutrality you have people who are making these moral justifications, you know “it keeps us free, it keeps the internet free” is what I think is the mantra they use, but you have companies who stand to gain, hugely, from net neutrality regulations. So in every instance, and I think if you scratch the surface hard enough of most, not all, but most consumer protection regulations or at least regulations that are put in place to “protect consumers in the market,” there is a bootlegger, and a Baptist. There is someone who has a strong financial interest in seeing this regulation initiated and essentially continued into the future, but you also have people who genuinely, maybe like your dad or my parents who do not—my parents do not—I have not been in a bank in a very, very long time. Like probably some of you have never gone to a bank, you deposit your check on your phone, and my parents are constantly “well how do you know it goes to the bank?” It just does. But they are like “but it has your number on it, and it is in the cloud, and people can go get it,” and you are just like “you just do not understand,” but you know there are people who have genuine moral issues, but they just essentially give political protection to those have a strong financial interest in seeing these things.

Derek Muller\textsuperscript{11} [from audience]

So, to give a little defense of the “Big Three” here—

Anderson

Muller is from Detroit. So, his baseball team was sponsored by the local dealership. [laughter]

\textsuperscript{11} For more information, visit https://law.pepperdine.edu/faculty-research/faculty/default.htm?faculty=derek_muller.
Shearer

But, is he running for office? [laughter]

Muller [from audience]

I wanted to talk a little bit about where this came from, because I think this is part of the divide, from the generational standpoint of understanding the history of automotive dealers. Most things in the United States you buy retail. You buy very few things direct from the manufacturer. Now sometimes you do, but you are not going to General Mills to buy Cheerios. You usually go to a grocery store. So, one hundred and ten years ago, when the automotive industry really takes off in America, they said, “Well what can I do with these? I guess I could sell them direct, I could go door-to-door, hire an encyclopedia salesman who wander around, or I can give them to retailers, who are going to sell what they have.” But, you have sort of a market that ends up sort of monopolizing this industry, in that it is only retail. You do not have any of that wholesale direct to consumers. Nowadays, if you want to buy something, if you want to buy clothes, you can buy them sometimes from the manufacturer themselves. Sometimes you go to the department store. You want to buy Apple products; sometimes you go to the Apple store, sometimes you go to Best Buy. You still have that direct from the manufacturer or from the retailer, that sort of does not exist because the auto dealers became so entrenched and powerful early on, that they have this large market. So, that is why I think that there are all these incumbent protection measures that happened to date. The auto industry, I am sure, would be happy to—and I think that is the point right. They will not upset their dealers anymore because that would be too great a risk and too disruptive to them. So, Tesla can start; Tesla can do that on their own. I think it is regulatory capture and that the dealers are powerful and the auto industry is powerful and they have a symbiotic relationship and they want to entrench it. But it came out of the unique way that this began and how profitable selling those automobiles were. But my question on regulatory capture is about Tesla’s capture of government, hinging on the fact that Tesla is a company that loses vast amounts of money and gains it all back from federal and state and largely California subsidies on zero-emission vehicles (or low emission vehicles), and they are basically a tax credit company that sells automobiles are sort of a front for the tax credit collection.

Koopman

So, the tax credit system used here pre-dated Tesla by a couple of years. As Tesla grew, California had its zero-emission vehicle credit. And ac-

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usuall y, so you get one credit for a car that goes 106 miles/gallon and you get two credits if it goes 212. And I think Tesla designed their cars to go 213 (designing it just enough to get two credits). And they lose a ton of money and so, essentially, California has these laws in place that say ‘you have to pay this state if you aren’t producing zero-emission vehicles’ or there is a secondary market for these credits. And essentially, Tesla is a losing venture and has always, I think since its inception, has lost money. The only quarter Tesla turned a profit was the result of the zero-emission vehicle credit in California. And they actually design their business model around their advertising. If you go to their website, they will say, “here is the list price, showing a $7500 federal tax credit you can take; here’s your state tax credit . . . oh, your state doesn’t have a state tax credit? Here is a link to lobby your state to implement a tax credit.” I would also add in the case of Tesla, New Jersey, for example: Chris Christie just signed the bill to legalize direct sales (for zero-emission vehicles). So, the bill says if you are a zero-emission vehicle or electric car company, you can sell directly to consumers. Everyone else, you still have to deal with this system, but the electric car companies get the direct-to-consumer approach. So, we ask, is it tacit capture? Has Tesla gone in and lobbied hard for these things, or in the case of Federal tax credit, are they bringing issues such as: the environment, and global warming? And it just so happens to be that Tesla is the primary beneficiary of these sorts of things. I think it is probably a mix of both. Tesla is not necessarily the victim—they are the benefit of poetical privilege on one side, and the victim of political privilege on the other.

Coker [from audience]

I wanted to see if Professor Anderson, or somebody wanted to examine the second question:

Anderson

I think what we are seeing is a proliferation of different types of technologies that allow various types of things to get done, through technology, on the Internet, historically in ways that have been much more costly, and much more formalized. Included in this we can include: Uber, Lyft, Task Rabbit and other types of technologies like these. The question is: How should those types of truly grassroots on one side, grass roots on the other, be regulated? You know, Tesla is one big company trying to sell to one group of people and another company selling to a second group; not we have these two groups interacting with one another. And what should be the regulatory structure that deals with

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that? Many sub-questions include: what about Unions? Employee protection? Consumer safety laws? Crowdfunding? So, I will open this to whoever on our panel wants to grab at that first.

Shearer

An example where it comes into the regulation; is it all going to come back to protecting the sanctity of the consumers. And there is a company, I believe its called CareNext.com. It is a huge market for taking care of home health, on-site for the elderly. The issue with it is that if you need in-home help, how do you know they are qualified? The only way you do it now is to go through an agency, relying on them to make sure the caregiver is vetted. And the issue with that is that the actual caregiver gets a small piece of the pie. And their rate is pretty high for caregiving and this other business model coming in is because of the Internet. Via the internet they are vetting the caregiver and actually giving the caregivers a bigger piece of the buy, and their actual cost to the consumer is half, opposed to going through the agency. And the value proposition that this company is doing is they are making sure that all of their employees are trained, insured, background checks are complete. And they can do them in such an efficient way that disrupts the current model. But this protects the consumer, and caregiver, while putting more money in the caregiver’s product. So, this is an example of how to stay within the regulations and making sure everyone in the food chain is taken care of.

Coker [on threatening capture with tax credits]

Are these start-up models more pure at heart, since they are bridging new business models to a bigger market? Does this change

Koopman

I do not think these companies are pure at heart. They are just as self-interested as everyone else and seeking profit through either productive or unproductive entrepreneurship. So, they can either be entrepreneurial on the front end; the story of Uber started in Paris where the owners could not get a cab; that is where it came form. Now you have Uber and Lyft being legalized in states (inducted into the cartel, if you will). But there were specific regulations defining what a ride-share or car-share was and they said: “here are the things you have to do.” And in specific details, it describes Uber or Lyft’s business model. This is like phase 2 of taxi regulations that has stifled the industry. The next company that starts these types of companies will have to join this fight too. There will constantly be a battle between those who are in the market already, against companies that want to enter the business and eat away at their profits. So no, I do not think they are pure.
A big picture moment would be nice in terms of regulations and specifically serving industry-regulation. Within industry regulation, there is this element of public health and safety. This is something that we are clear that if provided properly buy a company, they can often, but not always capture the benefits associated with providing for the best health and welfare for the consumers the problem is that if they are not able to capture all of those benefits, then why expand company respires on that? So, this enters government fiat—so when we get on a plane and it goes down, it is not good for the company, but we hope that it is infinitely bad for the company, so we are certain that they have done everything they could have to prevent this. The problem is that health and safety, and the clear need we have to protect consumers at larger or employment laws, has morphed into something else—like a cover to protect the zone (example of caretakers). The industry will say yes, you need us to verify qualification. But this is expensive, especially when the company says we will monitor, give you notices, and inspections and this all costs money. So, we need something in exchange, or someone will come in through the grey market (the unregulated market) and undermine us. SO they respond and say, “we will give you an exchange that is barriers to entry—so that you get a nice zone.” This is the taxi-medallion system—in NY, most children are raised not realizing that cars come in any other color but yellow, and the medallion system, what is literally a psychical acknowledgement, of “granting protection in exchange for the health and safety of consumers.” But the government is adding new regulations, like “you have to have a new care every four years. Or every two years you need a new car,” because this is good for health and safety. So, more and more regulations come in and actually, the initial bargain starts to look less and less profitable, and the people at the end of the value change (i.e. driver or nurse) are losing the value. This will get them upset since they are the ones qualified; they are the ones that will do something about it. The restraints or scarcity of not being able to find a cab in Paris is intentional. It is an intentionally scare commodity so government can justify putting on more and more regulations. There will be incentive for someone to come in and undercut these companies as prices and costs spike. There is a legitimate health and safety issue. But I would argue this is an initial qualification stage. Once this is met, regulation is impacted and morphed into something it should not be. Those regulators that try to control the actual contract and actual terms of the contract, especially between two businesses, and then you should look twice. These are the types of deals that will have the ultimate effect on the consumer.

Koopman

I would add to that also, the fact that they are introducing artificial barrier to entries into the market, and a lot of the competitors that are in it today
never actually benefited from the regulation in the first place. Think of taxis again—in 1930s when New York City introduced the medallion system: all the taxes that were first granted the medallion are the big winners; they are the traditional winners from no regulation-to-regulation. They did not have to buy in; they did not have to expend all these resources; they did not have to go through this process. Over time, as more people entered, the price of the medallion shot up, to now where it is $1 million for the medallion. The privilege to drive a taxi car is $1 million. So, all the benefits—increased prices the drivers are able to charge; the quasi-monopoly rents you are able to get—have been capitalized into the price of the medallion. So these people are not winning, they are just breaking event. So, Uber and Lyft are eating away at the value of these drivers who do not get a whole lot out of it [the regulatory protections]. And I think this is the big issue in terms of deregulating these markets, or finding more efficient regulations in these markets, since there will really be traditional losers here, who will be made worse of.

Shearer

So here there is massive capital infusion to build the medallion. So how do we regulate it to capture the value of the medallion? The arguments get twisted later on—well everyone seems to forget the underlying arguments due to the side deals built into the value-chain over time.

Koopman

This seems to be heading towards what I have heard called “deregulatory takings.” So you have Fifth Amendment Takings, and then you have a step out of it where the spectrum that you own, or medallion purchased, is now valueless, or the regulatory structure has changed and you are losing out. So, how do you compensate these people? Is it the same takings in the sense that your house is now owned by the government? Is taking the medallion away the same type? Does this trigger the same type of “just compensation” that a traditional taking would?

[inaudible question from audience]

Shearer

Understanding and being aware of this battle is key. And what has been seen, and a strategy is to spend as much time figuring out how a highly regulated system works. If you are entering this market, figure out which of the incumbents can you align with? And give them a reason for them not to shoot you. It usually is, that if you work with them, you will give them a competitive edge, and ride their coattail into changing the regulations. The entrepreneurs,
innovators, and disruptors cannot afford to fight the lobbying and cannot afford the lobbyists. You have to become the villain.

[inaudible question from audience]

Shearer

For patents, there is disruption to the system when the law changes. It used to be: first invented, as long as you could document, rather than first to file. If there are a couple of people in a garage inventing something that now one ever did—if you are in the garage, it means you likely live there, meaning you may not have enough money to make the filings. Trying to figure out how to file this patent, may take the last dollar out of your pocket. So, this hurts the small-time inventors. On the other side, there are mega companies with thousands of inventors through a network, and they cover all the costs, and bring in inventors and give them every type of toy imaginable. It is a patent factor where the; lawyers are scribing all this stuff, and at the end of the day, 15 or so patents are made. But for the little guy, it cost $750 just to file, and it will cost another $10,000 to enter the US market, and if it is a world-wide market, it will cost even millions more dollars even before you hit the market. But this is part of the regulations, and there are seismic shifts on the impacts it does to innovation.

Coker [on net-neutrality]

Does this play a part in allowing an even playing field?

Boliek

The quick answer is no. And the reason is because there was never a real issue. And it has famously been said that net-neutrality is a solution in search of a problem and the concern of competitors, or concerns that have been floated, is that if the direct link to the end user—for example, if Comcast is seeking to find an inventor's new App and blocks it because it will be problematic—this has just not happened. There have been, in the 20 years of a commercialized Internet, has been less than a handful of incidents that are characterized as examples of going against net-neutrality. Net-neutrality itself has morphed and changed. What we have now is not net-neutrality rather; we have Title 2 (the statute written in 1934 back when the Internet was in its hay-day). Its two provisions that policy-makers are hanging their hats on are provisions 201 and 202. These have origins directly back to another tech-wonder, the railroads in 1887. This is our Internet law—from 1887. So, we are not talking about net-neutrality; we are talking about Title 2. SO how will this help the Apps? Will this help them get investments? This does not change the truth of the Internet. Everyone interconnects—some people are big (Netflix) and some people are
small. Depending on how much traffic you are sending to Comcast—they will either charge you, or realize the amount of traffic is equal, so they call it wash. Millions of transactions are done are a handshake, nod, tweet, or SMS. That has been the way of the world. Title 2 is not that way. It is unclear what it will do to the group of people that are concerned about getting into the market. Big companies like Netflix, think they will decrease the cost-to-market, expecting the consumer to pay more, to reduce their own costs. The view, of the group has pushed for Title 2, has shown aggression of wanting to put as much pricing pressure on consumers and not on anyone else in what is an incredible web. So, this is going to be a long, litigious road, and it is unclear how this will help application providers and more than they have.

Anderson [on turning towards the peer-to-peer model compared to the regulator model]

One of the big questions here is whether reputation in the current economy where information flows so freely, will be able to fill the hole where regulation was traditionally thought necessary to handle? Will the caregiving company’s reputation be able to overcome the increased charges, or in the case of Uber, the attacks on passengers, or various other things. This is in favor of the reputational model since Uber takes a hit with bad press or bad reputations. So the person using Uber, that is on the edge whether or not to use a regular taxi or not, might lean the other way and just get in the cab. So, one of the big picture items is that there was a time where people’s information was so low, because information was only exchanged through word-of-mouth or the one channel on the radio. And, regulation was the only way to protect people from unscrupulous weirdoes—you think of the door-to-door salesmen. Have we evolved as a society where reputational information will be sufficient to displace traditional regulation in many of these areas? I think there is reason for confidence, but also reason for skepticism.

Shearer

I think that reputation causes self-regulation as the provider. I think this will work in the long run since they cannot hide anymore. Everything is so exposed that unless you are in a dark alley buying something from Craigslist, the word gets out. It will make them kill a small company in an instant. I think it is because of net-neutrality; everyone has information at his or her fingertips in so many different forms. I think, by the nature of it, it is self-regulating since companies like this cannot afford for something to go wrong. Reputation in a modern economy should be able to augment, rather than just displace, the traditional regulations. I mean, how long does it actually take for a congressman to make a decision—to even vote on anything? Or for something to even show up?
I think reputation has its own regulatory effects. I do not think Uber or Lyft or other sharing companies are operating unregulated. They are just not operating in the traditional regulatory methods. There are still torts, criminal law, etc. If I get defrauded, I can still take this guy or girl to court, even though they are not operating as a licensed taxi service. If they hurt me, I can use the police powers of the state to have some semblance of justice. But one thing is the reputation. Uber started getting a bad name for themselves. And in D.C. and Baltimore, they had “Puppy Day”—delivering puppies from the local Humane Society; or they did “Ice Cream” day on demand. And a guy in a Mercedes Benz, and in a suit, would deliver ice cream to your door. So, they were rebuilding their reputation with people. But also, a lot of these systems for example, with 1-to-5-star rating system, have a built-in regulatory system embedded in Uber’s system. So for example, take Las Vegas—as long as the Las Vegas airport system has existed, taxicabs have been long-hauling people to the strip. There are tow ways to get there: (1) The straight way, and (2) The not so straight way. And these taxi drivers take you the not-so-straight way. The Las Vegas agency regulating this has been fighting this for five decades, doing stings, having people file reports if they believe they have been long-hauled. Uber fixes this in a matter of minutes. You know you have been long-hauled based on the map, since it tells you where you are supposed to be going. And if you have been long-hauled, you give the driver one star. It asks you why, and in a manner of minutes, someone from the company emails you and asks you what happened. You tell them you were long-hauled, and they regulate the system. They police this system themselves—those who get below a certain rating are removed from the system. And people with a higher rating actually get incentives. You have a 4.9 rating, you get to choose who you pick up before someone with a 4.7 rating. The drivers are rated, but so are the consumers. There is strong incentive for both consumers and drivers to be the best version of themselves. At the end of the day, if you have a poor rating, drivers won’t pick you up. As a driver, they will remove you from the system. This system makes for a better process for everyone involved.

[from audience]

Are we outgrowing the need for reputation? Is fear where someone is so entrenched that reputation is not a big deal?

Anderson

What is the alternative? Can you imagine what it is like if there is an actual complaint about a Chicago taxicab and you wanted to complain to some
government agency? I think most people would not do this, because they know it will just get filed in some paperwork somewhere. This is just inept. Once you build up a reputation to a certain point where someone will choose your brand no matter what, you have some immunity to little mistakes here and there. The alternative to having a bureaucrat to say yes or know, or delegating what they should do, it is hard to imagine this being more responsive. An example could be Google—they are a very good search engine, but I do not think they are so superior to competitors. It is a reputation that makes them superior. Because of this power, they know consumers will not switch services, since there is not much to switch to.

Shearer

Does this create a barrier to players coming in? There are much better search engines than Google, and there is not much incentive to make them better unless they have to. Its only when an anomaly pops up where a better search engine hits the market, does there become a choice. It is the reputation that creates your quasi-monopoly if your reputation is so good, but it may not be too good in the long run to the consumer.

Koopman

Google’s dominance is a fact of people’s willingness to give up their privacy for efficient email and search engines. The ads are even customized to the user. They continually market to the consumer, but if you switch to other browsers, you would not have this same advertising. For example, DuckDuckGo is a way for people to search the Internet with more privacy. These systems are not free. You are not transacting with money, but rather, transacting with your personal information. So, you are giving something up to get something in return. This is the same with these sharing-economy companies, like Uber. Uber can tell when people are picked up and dropped off; compiling data of where and when people are going, which is all stated in the user agreement. But people are okay with this since they get a better deal on a ride.

Boliek

There are two different factors: 1. Market conditions, which is picked up with Google, and of course, Comcast, which has a lot of customers. People on Yelp say they will give one start because Yelp will not let them give zero. SO there is a blend—was this reflected because of market power? Or was this reflected because they had market power through their reputation, which is perpetuating in itself. So, this is reflected, where Professor Anderson began this question. In the cases where you do have some choice, where, limiting the qualifications of the health and safety requirements, and leaving the rest of the ar-
rangements to the free market, can the reputation fill the gaps that removing regulation will do? And I think it can, in many ways, in the banking industry, there is a fallacy out there, that because it is so strong, regulation is really not available, and there really are not many alternatives. Regulation is not really a big deal, because it does not really inhibit people from going. Title 2 supports say, “People are going to invest regardless of regulations.” This is not true; this limits their choices. It is always easy to regulate someone who has some cost; those that are immovable. They will keep investing because to walk away from the Medallion is huge; to walk away from the fiber is huge. So yes, they will keep trying to keep that business going; it does not just mean they will get the benefit of the regulation. So to the extent we can peel that back, and allow competition to come in, can reputation itself feel this risk analysis that consumers have to make that usually they can say, oh its government sealed, there is no risk. So to let some of the market risk come in, and let reputation fill the gap, is the premise. I think reputation can fill a lot of the gaps. Consumers can start taking their own risks. How do you maintain the integrity of the reputation system itself? Yelp has this problem all the time: that consumers or business owners say, “This guy is my crazy neighbor, and wrote this [bad review] because he hates my dog, rather than my bakery.” So, Yelp is getting increased verifications. Regulation can come in and verify this. With consumer credit ratings, such as in the Banking Industry, it is difficult to determine the validity of the regulating agency. How do you assure to the consumer that the reputation system itself is viable?

Koopman

This is a strong argument people are making: you should own your reputation the same way you own anything else about you. And you should be able to get a credit-report for consumers based on the aggregation of various information. Inability to have a cause of action to fight for your given “reputation” creates an ongoing [policy] fight. For example, in Europe, many people are seeking to be erased from the Internet.

Boliek

Of course, in Economics, this can be used strategically by competitors about a competitor’s reputation, consumer practices, etc. But anonymity of this process is often its greatest failing rather than its greatest strength.

Shearer

If you see what is really going on in other side markets and really verifying the information. A new business being launched is Surenify, with a busi-
ness model as follows: like Match.com or EHarmony that create various profiles. But how do you know they are true? This business model gathers all of the statistics, and identifies what is true. This system says, as a third party, you will pay to have yourself validated, and they agree that what is being said on your profile is true. So it is not the consumer that is saying their information is true, rather, they are paying to have this quality check by Surenify. And the type of information is also checked. A system like this could determine whether or not there is a valid reputation check.

Koopman

This issue even goes back to the “Market for Lemons,” by George Akerlof, discussing asymmetric information: where one party has more information about what they are going to do or what their product is, say used cars, than the purchasers. People are willing to pay less because there are lemons and [consumers] cannot tell whether or not there is a lemon. This creates a downward spiral in the used car market, as the cars get worse and worse, thus creating a self-implosion of the used-car market. In his conclusion, asymmetric information is essentially a justification for a lot of these regulations and the moral hazard that comes along with this. So the idea that “I know more about what I am going to do than you do” and “you don’t know how I am going to act,” gives the person with the knowledge some ability to act in ways they otherwise wouldn’t if there was full transparency. The idea is that government regulation can be overcome with grantees and warranties, but reputation can help overcome these issues too.

Coker

Alright if I can get everyone’s attention we would like to get started again. It is past 1:30pm. I kind of like to introduce some of the panelists once again since Professor Anderson is joining us along with John Shearer and Mr. Koopman. Erik already had a chance to introduce himself. Makan I would like to let him tell us exactly what he does. I know a little bit of what he does. Basically, he is involved in a start up, and one that will give us some discussion. So if you want to say a bit about that, I will let you put that into your own words if you like.

Sure. I am a practicing lawyer. Trying to change—I guess to disrupt a little bit—what you guys have been talking about. This became kind of a side project about two years ago for me and a partner of mine, who used to be a law clerk for me back when I worked at the Senate Judiciary committee. And we stayed in touch. He had, after a long practice, he had a start up and he sold it successfully, and we began this process. What we are trying to do is to really disrupt the dispute resolution and the arbitration business. We are starting with the small claims court although our platform is a platform that we are selling to enterprise companies, and we are starting with a lot of the sharing economy. So in number of the companies that have been discussing, we are an active discussion, we are close to pilot with two of them—task rabbit and thumbtack—are two companies that we are close and have had vast discussion over the last year. What we would do would be to implement, as part of the arbitration clause, is an arbitration clause that they go on to Preconcile, which is our platform from zero to ten thousand dollar limit. Couple of our customers have asked to go up to thirty and fifty thousand. But it will be a binding contract. Our platform takes the customer service dispute mechanism, and so you take the information in. A customer calls and says; let us just say Airbnb—another customer we are talking to. They say that you know “I rented whatever a two bedroom, I cam in it’s really not, it’s a one bedroom, it’s a single king. I had to go over to the Malibu Beach Inn and rent for 700 hundred dollars a night. We are staying here for five nights, at four hundred bucks. Whatever, I have about two thousand dollars in damages. And typically, you do not want to go to—you are not going to hire a lawyer that is rational to do that on a contingency and hopefully, you are not rational enough for two thousand bucks to hire a lawyer to solve. That will be two billable hours. And the company is going to cost them a lot of money. So, for the company, there are some benefits. They are getting customer feedback. They are avoiding litigation costs. Facebook’s general counsel said, “If we’ve lost 85% of these cases, we’d still love this.” And so the complaint comes in, “I want x amount.” The company deals with it. They either will resolve it immediately, or they will say “No. You know what, here is what you actually said. We have the record.” They will put in a hundred word, plus a hundred word statement—is what the customer’s complaint would be. So, think of it as an abbreviated small claims court complaint. Three to four uploads. One of our customers asked, instead of three—that is our base model—to put four. You can take a picture of what went wrong. Take a picture at your seat. This is all mobile. And you would load it. It goes into the system of customer service. If they do not resolve it, they have one back and forth. So they can counter. Say “you know, instead of two thousand bucks, we’ll give you a thousand for future stay with us.” When you do that, you can either say “yes” if you do not move on. If they do not then it goes to an arbitrator on our platform. So, we are a double end independent company. If you have a dispute, you are not dealing
with Airbnb, Uber, or Thumbtack to resolve your dispute. You are not going to them to be the judge and the jury of this. Our platform is independent from the company. But so are our arbitrators. Our arbitrators are folks that sign up with us. I have a ton of colleagues—incredible academic background, former deputy white house counsel, justice department official. We have no interest to go back to the big fancy law firms doing billable hours. They are at home. They would love to sit there and be the judge. So they will become an online judge signed up with us. They will say, “Look I’ll handle twenty cases.” Or new attorneys. And the case is assigned to them based on their level of interest, or what it is that they want to do, or how many. They will read the two one hundred word statements, make a decision, issue a statement. Depending on how the arbitration clause is set up, it could either be binding, and now you have an enforceable arbitration resolution. If it is—if they decide that it’s non-binding—so some companies may say “we don’t want it to be binding, but it will be a pass, and if we can clear twenty to forty percent of these, that’s huge savings for us and we’re getting customer information, and they probably saved a customer. So, that is what we are doing. We will be launching technically the second week in April and on a small scale. We are talking to a lot of companies who have expressed an interest, so our entry point is that.

_Coker_

Obviously, it overlaps a lot with our discussion. We have already had in the morning really interesting further discussion of what challenges that entails. We are going to let Bunnie introduce Erik Syderson because she has worked with him.

_Poulard_

I just wanted to give an introduction and thank Erik for the short notice to agree to join the panel. Erik and I worked together at Raines Feldman - my future firm. Erik earned his JD from Loyola Law School. He is an Internet and technology attorney. He co-chairs the Internet and digital media practice group at Spellman. He also wanted to go into digital media advertising as well as intellectual property rights for both public and private companies. His practice includes advising Internet companies with federal and states statutes. Some examples include digital millennium copyright act, the anti-cyber spotting consumer protection act, and Internet act. Erik is a member of the California state bar of cyber lock committee, who regularly publishes his work related to his area of practice, serves as a speaker for California bar. In 2015, he was named super lawyer. So, thank you Erik for joining us.
Erik Syverson

You just have to know a lot of people to become a super lawyer. Well we’ve throughout the day today, some people here are new, we’ve been talking essentially about, I’d say broadly speaking the relationship between disruptive entrepreneurial enterprises—the Uber, the Tesla, the Lyft, the Airbnb, different types of business that have sort of exploited this, the regulatory interface with business and either found a way around it, or found a way to thread the needle into the value proposition that have been previously reserved for regulated industry. Or, in some cases, to some extent, outright challenged the law in ways that let populist appeal of the product overwhelm the regulators’ desire to stand by some. This is a great sort of segway into the conversation. And, of course, I wanted to drop the bomb of the orphan in the room, which gives me a little bit of an opportunity to do so, to some extent, which is, you know, we are all going to be lawyers or are lawyers, and we’re protected by regulatory cartel, or body of what one might say. There is absolutely, you know, there are many reasons why lawyers’ jobs are being deconstructed and outsourced, off-shored. You know there are people out there in India performing tasks that previously American lawyers used to do. So I’d like to just invite our panelist in addition to the other things we’ll be talking about to throw in the possibility to look at our own regulated, protected little industry and decide, you know, are we vulnerable to this type of entrepreneurial activity in legal field as well. This is supposed to be a free-flowing, open discussion. We got all the die-hards here in the final afternoon session. So I’d like to give our especially two new panelist here opportunities to talk about how they see the regulatory state entrenched interest, political interests, lobbying groups, and special interest—all kinds of things, either trying to stifle innovation that would disrupt those industries, how those entrepreneurialships will prevail. Or, perhaps, how to defend some of the entrenched industries as having actually a good rationale and policy for their existence. So an example we are talking about: Tesla’s battle with the car dealership, dealer requirements for the distribution of vehicles, the travails of Uber’s with the various taxi commissions and regulations, and so forth. So, I would just like to take that and apply it to whatever you’d like to talk about in this realm.

Delrahim

Sure. Let me jump in on that. The Tesla, Uber issue is an interesting one. I will give you a quick background, which kind of unexpectedly ties in with little bit of arbitration and Preconcile. The only industry, the only as a whole, that in the federal statute dealing with arbitration, that has an exemption is the auto dealers. This came in on 2003. They are the manufacturer to the auto dealer arbitrations clauses in their contract. And one fell swoop was completely negated. I will tell you how that happened. I was the chief counsel for senate judiciary committee at the time. Auto dealers had this legislation, be-
cause auto dealers have such a horrible bargaining power, compared to consumers. And they said “hey we just don’t want this. We are forced into arbitration. We want to be able to sue for Chrysler, Toyota, and all of them.” National Auto Dealer’s Association came in. Republicans, whom I worked for when Eve was chairman, republicans were in the power in both the house and the senate. President Bush was the President. Republicans tend to favor ideological arbitration, and limiting litigation as much as possible. This legislation comes up. We are basically—there is a lot of support for it. Not for the policy. To the bone of every single senator that I was dealing with said they “We hate this legislation, but I’ve got a heck of a lot more dealers in my district than I have manufacturers manufacturing.” So we went into the leadership office. My boss basically told me, “Find a way to pass this law.” We brought this up; we could not get thirty votes for this darn thing. If we do, what is going to happen with the consumer groups who come in and say, “we want to undue the arbitration clauses in credit card contracts”? That seems to have even more policy rationale for it. People said, “It doesn’t really matter.” And so, we are there with the senate majority leader, the speaker of the house, the house and the senate judiciary chairman doing what has called a conference between the two bills on something completely unrelated. The arbitration bill did not pass either the senate or the house. Never got a markup or committee action or anything. We had a debate. Every single member of the congress sitting there at the leadership said, “I hate as a matter of policy, but we have to do it.” So, my idea was “let’s jam it into this bill that’s going to pass, and under the procedures, you can’t amend it.” Once it goes out of the conference, once the house and senate, then you have to vote either up or down. And there are a lot of goodies in there. So strategically, that is the only way I can pass that for my boss. So we did. Every single one of them said “I hate this and we’re going to come ruin the day when consumer groups are going to want to come and do this, and any other agreements.” It got passed; it is part of the law. It just shows how powerful dealers are. So, if you are technology company who wants to—right now who don’t feel the real threat feel the direct effects of Tesla, but if they want to ban it, they can do that, until there’s a countervailing consumer outcry to change the law. So, entrenched forces are incredibly powerful, and the political dynamics regardless of the policy have to be factored into any new start up, any new disruptive technology.

Syverson

So picking up on that, I am a litigator, so I am involved in hand-to-hand combat of lawsuits. I get probably ten calls any day—would people want to hire me to defend them or bring a lawsuit. I think what is interesting to me in the context of litigation and start-ups and disruptive technologies—earlier on in my career, I would do what I would call a transactional type of work or people would call me up and say “Hey I want to start up a new business. Is this legal?” As a young lawyer, everybody called me their business was a violation of law.
It is kind of the nature of innovative company. All the biggies we can think of—the Ubers and the Youtubes—they would have come to me as a young lawyer and I would have said, “You can’t serve your business. You’re going to get sued out of existence.” What is interesting to me, YouTube is a very interesting company to me, and probably made the biggest impression on how I see the law and litigation—just what really matters. The fact of the matter is the law does not matter that much. Things kind of come down to practical considerations as far as lawsuits. It comes down to time and money. Let me bring it back to YouTube. YouTube started 2006. When YouTube started out, I do not know if everyone remembers, it was just a copyright infringement cesspool. Everything that they are infringing—you can watch full episodes of Seinfeld. I love Seinfeld. I can still go and watch a ton of content that is copyright infringing. I love sports also. I can watch any old NFL game I want. This infringed NFL’s copyright. And YouTube was started in a garage—a smart guy part of the Paypal mafia. The big studios did not sue YouTube when these guys were running it out of their garage. Everyone knows the big litigation, all the studios that sued YouTube, but when did they do it? After who bought them for a billion dollars? Google. Then they waged war in the courts, and spent tens of millions of dollars on lawyers. Has it affected anything? YouTube is still here, still standing, totally disruptive, totally great. I really like it. I guess the lesson is, since most of you will probably become young lawyers, is to get a grasp of what really drives things in innovation, the practical matters. The longer I practice, I realize the law really does not matter that much. I know it might seem odd to hear that, but it really does not determine the outcome of a lot of cases. Particularly the close ones. The YouTube cases could have gone either way. It would’ve been totally legitimate if the studios prevailed and YouTube sued out of existence for a hundred billion dollars, or whatever the statutory damages would’ve added up to—which would be mind boggling.

Delrahim

Napster and Aereo are perfect examples of ones that were shut down by the courts and looked the other way.

Syverson

Great point to make. Absolutely. When you are an innovator and you have one of these companies, it is kind of a roll of a dice, and kind of how things play out. Google had the money and afford to wage that war, and ultimately prevailed. I am not sure; well, if some of the folks on the losing side had the proper ammunition at the end of the day. Anyway.

17 http://www.rhapsody.com/napster
18 https://www.aereo.com/
It is interesting to see how this sort of world of fight or the resources to fight and stuff like that can ultimately determine whether a business that’s actually fairly clearly either infringing directly on the legal regime or enabling others to do so in a fairly straightforward way. It can come down to that where to fairly similar businesses—one keeps going up, one keeps going completely down. So I guess, since we do have people who practice law here, how do you deal with an entrepreneur comes to you, I realize not all of you do are doing counseling, how would you see it if attorneys, so our students will be attorneys for entrepreneurial ventures, when someone comes to you and says “Hey I’ve got a great idea. I’m going to help wineries sell direct to consumers or something.” To just pick one example of yet another thing that is extremely, heavily regulated, almost enshrined into our constitution that you cannot do that to a large extent. Our former dean was involved very heavily in that litigation. When someone comes to you and says “I have a great idea,” somewhat naively, perhaps not even realizing that it’s illegal, “I’m going to do this because there’s a great need for it—I’m going to have a ride sharing services because taxis are too expensive and too difficult.” What do you do there? Do you shut them down? Do you say that is just illegal? Or it is too close to the line; you should stay away from that. Or do you encourage them to take the risk? How does a lawyer navigate that?

You are going to get sued. It is just a matter of time. Do not worry about it while you are not big. Once you start blowing up, you are going to face a class action. Any consumer facing business is going to have a lot of litigation. I typically have one word for folks and it’s insurance. Pretty common sense. I have had this actually play out in my career where when I had a smaller practice it was a company, one where a lot of you would know, and they started blowing up. Young hotshots from the grade school. They needed a bigger law firm, but my parting words of wisdom to them were—and I did not even know if they were breaking the law or not. I get these calls all the time. It’s another sort of area of innovation that find interesting: online gambling. I get calls all the time. I want to advice again that I tell people all the time “I have no idea what’s illegal or legal as far as gambling.” I really do not because I cant place a bet on the green day packers, but I can play one-day fantasy sports. It is very confusing but anyway, I tell people to buy insurance. The good news is that there is a really developing, thriving cyber liability insurance market. The big boys are out of London. It used to be that only Google or Yelp could afford these policies. Now, mom and pop companies can buy them. I defend a lot of them on lawsuits. You do not have to be a big boy to buy cyber liability insurance. I typically do a lot of trademark and copyright defense work. It is typically for small to medium size companies. I do not represent the Google’s or the Yelp’s of the
world, because my firm is a boutique firm. We are not that big. We do not have that manpower. Anyway, insurance is an absolute must, as soon a young company can afford it. Now most of them will tell you in Silicon Beach, “We can’t afford it. We need every penny to build our product.” And that is true, but once you get to a certain point, maybe instead of hiring another hotshot coder, or something like that, find and pay an insurance premium.

Koopman

I would add that, I think your sentiment rings true. In my experience, I was at a workshop recently with a whole bunch of guys who were innovator types. One of them was starting—he is out of Seattle - he is starting this website. He’s like “I have no idea if it’s legal or not.” He said, “Actually, I don’t even want to know. He said, “my goal is not to comply with anything. It is to get as big and as popular as fast as I can. Because by the time that people realize I’m around, I want to have such a devoted following, that I have the resources both in the courts of public opinion and in courts of law to sort of fight these things off. Basically, it is a matter of time before I find myself in times of trouble. So there’s no sense in me hamstringing myself today when I can just grow to absorb these blows tomorrow.” I think that works in a world where you know the laws exists and they may apply to you. However, in a lot of cases, you have no idea that the law applies to you until you get a letter from an agency or someone sues you. For example, the initial drone regulations from the FAA,\footnote{The FAA has passed new, more recent regulations. See https://www.faa.gov/uas/} were not passed with drones in mind. The law that they are actually using to say “you cannot use drones for commercial purposes,” they were not thinking of drones. At least I do not think so when they wrote it. Drones were not a thing when they wrote the laws. They are like vestigial regulation. It is like your appendix. These laws were around at some time, and they meant something maybe at one time, maybe at one time there was a market failure. We have evolved our way out of it, but they are still around. The only time they become a problem is when they explode. When all of a sudden your appendix ruptures, or you get a letter from a federal agency telling you that you are now in violation of some law that was passed a hundred and fifty years ago.

Anderson

Drones are a great example actually. It is still playing out, but when I talk to people who actually know about the law, the laws of drones—we have one of them here—the vast majority of the things that are being done are illegal. In fact, as much as putting up and taking a video with your little helicopter, and putting it up on YouTube could arguably be commercial in nature. Actually, I realized that I have two of those up on YouTube. But, I think that technology is
out-evolving the regulation. I think it is obvious that’s happening. I think with the drones and things like this is, you see that there’s sort of, I think it’s possible that we’ve entered into a phase where the populists uproar over taking things away from the people might actually be able to overcome entrenched interest and capture regulatory agencies and things like that. I do not see how the FAA will be able to actually stop people from flying remote control helicopter. They tried but it is the same thing with Uber too. If you had an upstart that was less bold and brash, they might have gone down. I can just imagine how that whole thing could have turned out differently if there had been some lawyer that somebody had gone to in the beginning, and they said “Oh well you can’t do that. You need a medallion to run a taxi and you have to do this and that.” Probably nine out of ten entrepreneurs after they consulted that lawyer would have just said “Oh I guess I can’t do it.” Some either do not talk to their lawyer or keep going. So as a result, we have these giant, or immensely transformative disruptive companies that are sort of—their birth is in basically exploiting a regulatory pot of value that has been allocated by the law to certain people who are in these select group. They are chipping away at it, and it is a lot of money to take away. It is actually somewhat surprising when you look at number of things that you have to actually have a governmental license in order to do commercially. Things that people do all the time. I keep getting back the generational divide, but people in the younger generation are saying “Hey I drive a car every day. Why can I not be paid for somebody to go with me, or share a ride, or something? It’s not like I’m any more dangerous driving in that capacity, than in my regular capacity.” I do not know what the populist uproar would be the source behind your company, but what are you exploiting?

Delrahim

Against?

Anderson

Against for, where is the value pot that you are arbitraging?

Delrahim

If you’re starting a new company, (1) make sure you go to a lawyer who doesn’t just, no matter what you’re doing, it’s easy to come up with problems why you shouldn’t be doing it. I would say eight out of ten lawyers that is what they do. Make sure you go to a lawyer if you can - part of this depends on your risk tolerance - is find a lawyer who says, “yes, here are the problem that you’re going into completely open eyes, but here’s ways to mitigate that, or here’s ways to minimize that.” To give you solution. Those are kind of rare—lawyers who provide you solutions rather than give you a list of problems which
turn into liabilities later. So we do a lot of gaming work out of our Las Vegas office. Everybody except for Las Vegas send every regulatory work, every casino there, is done by our firm, and former gaming control chairman. We have a bit of a more conservative approach, because these are gaming license owners. So Steve Wynn is not going to risk getting into a particular type of online gambling business. His risk tolerance is very low, because he does not want to risk losing his gaming licenses. We got a call recently about somebody who wanted to do what Draftgames and FanDuel do—these are the two fantasy sports leagues. And they say, “Hey this is making a ton of money out there.” Professor Scarrberry, at the unfortunate duty or responsibility to review my final exam from last semester, and my fact pattern for one of the two exam questions was specifically on this issue, was a sports betting site on one side, and what would be the issues raised. Draftgames and FanDuel both went to a particular lawyer in a law firm and got an opinion. A legal opinion that said what they are doing is legal. That is fine. Why? Because congress passed a law in 2006, the Unlawful Internet Gaming Enforcement Act, which made it illegal payment transfer for online gambling that’s illegal. They did not define what that is. It is whatever that is. The payment transfer of something illegal. Congress, since 1960s, has something called a Wire Act, which makes sports betting online illegal. That is Title 18 of the US code. That is a criminal violation. The UIGEA\(^2\) that passed in 2006, whatever it is—Title 31, or 17, Financial Regulatory—it is a completely different law. The legal opinion, which I read because several of my clients are sponsored by DraftKings, says because that’s the last congressional pronouncement on online gaming, and there’s an exemption from the second law for the purposes of fantasy sports, fantasy sports leagues are exempt from the first law. First year of law school, if you understand statutory interpretation, hopefully all of you guys do, there is no way. So let us just take an analogy, selling methamphetamine on PCH is a criminal violation. Great. Congress comes up with a second law that says that payment transfer related to the sale of methamphetamine is illegal. Except for there is an exemption. Let us just say, surfers, cannot—because they are powerful—you have an exemption for surfer from the second law, not from the first law. So somebody gives a legal opinion saying “You know what? Because that was the last pronouncement on sale of methamphetamines, all surfers can go on PCH and sell meth.” Well that is not true because they are violating first criminal act, the act of the sale. The payment transfer is not violation. So, Visa and MasterCard can do all they want for surfers. Anybody else is not. It is just an asinine opinion of malpractice in my view. But, if you are a small firm, and you got good insurance, you can give those types of opinions. Those guys are making a ton of money. We almost, in our class—I teach this class called, Policy and Regulation of Entertainment and Business—we were going to do it as a practical for these students to shut them down. I can shut down DraftKings without passing a single legislation within

48 hours, if we really wanted to, and there goes a hundred and fifty millions dollars of IBITA (?) a year. The way to do that would be is if some senator, let’s just say he comes from a state that doesn’t like gambling like Utah, Idaho, Hawaii, where it’s in their constitution, and you want to make a name for yourself. If you are a senator you can do that. You need to do that to get reelected. You are on the banking committee. You write a letter to VISA, MasterCard, Bank of America, US Bank, JP Morgan, and say, “Dear Chairman so and so. It is our view and our understanding that you are doing this. It is our view—it doesn’t have to be correct, it doesn’t have to be a court - that what you’re doing, although exempt from the EUGEA still violates the Wire Act.” Within six minutes, the legal department of that bank gets that, because they’re making whatever the interchange fee, fifty bases points on couple of hundred million dollars of transactions, they are not going to risk what they’re doing with the senate of all the other banking regulations. So, they will shut that down in a New York minute, and those guys are out. I have spoken to the CEO of DraftKings, and said “look you really should be paying attention to what’s going on there.” “Ah no, we’re okay. Really.” So there is a practical risk that has nothing to do with the law that comes from the regulatory side that you need to be careful of. So, if they are not watching what they are doing on the capital hill, making sure they create grass roots to protect them, they could be shut down quickly. And it does not take a whole lot for no-named congressman with one letter to all of a sudden to a national household name.

Shearer

I can bring up a real example. By the way, disclaimer, I am not a lawyer so I do not have any adult supervision. I mentioned in earlier with the FCC, with the company I started called Powercast. It was for wireless power. We won the CES 2007 Best Merging Technology. It’s a true story based on what you just said what occurred to us. I had mentioned that I had done all the homework before even starting a company. If I am going to have to change a regulation, the FCC rules, it is a no starter. Even as an entrepreneur, you should be telling an entrepreneur you cannot do something, that is the first thing you do is do it. Just watch. This one I knew because I had some friends who were pretty high level of the FCC. I went in and did the homework, and found out that I could operate and power products wirelessly, as long as I stayed within part 15 and the part 18—primarily part 18. I was in a room like this where there was fifty of the FCC. Go back to 2001, when I’m starting on this project, and with fifty of them in the room, I said, “This is what I’m going to do. What laws or regulations do I run under?” And they said “Part 15 and part 18 on the transmit side. On the receipt, side does not matter. You are a receiver as long as you are not taking the data or the content. You’re just absorbing the energy from these carriers.” I said, “cool” and I showed it and they thought it was the coolest thing ever. I said, “I’m going to get investment dollars in here. I need to make sure
that we can go to market.” They literally took me up and said, “Listen. We’re going to take it to the big guy who wrote the regulation.” They took me to the zoneless and said “As long as you do this . . . .” So, flash forward. It is 2007 CES, we did not have website until the night of the CES. We were running stilts for day.

*Delrahim*

That is the consumer electronics show. It is a big deal.

*Shearer*

Yeah. It was a big deal. We had a half a million hits on our website that day. We did not website three days before. So flash forward, we cut this deal with Phillips, we’re going to power their Christmas tree light with this wireless transmitter that goes into the tree and that powers all the LED lights. It was really cool. So, they place this order. So we have all this press, and we were moving forward. We were all in. We had to build these things. This is the January, February, March, and this is to hit that Christmas season. Normally companies buy these stuff the year before. So, we are pushing everything. I had this great relationship with the FCC. I get this envelope in the mail and I am traveling for business. Basically, it is a cease and desist from the FCC. I am thinking “What the heck? Who is it from? This was one of the guys who said go ahead and do this.” What happened was because I am coming in and disrupting people who make all sorts of money of connectors, chargers, and adapters that I am messing with the multi-billion industry. You are going to get rid of chargers and batteries, and do these things close range. That is not a good thing. We had a lot of press, and there was newspaper articles. We had the *Business 2.0.*, *Popular Science*, and *Moviehead Press*. There were pictures and stuff. What happened was that someone in the industry did not like us? They created counterfeit copies of those magazines, and inserted quotes from our engineering chief technologists saying stuff that we are operating on these certain frequencies. And then they made sure that they were fed through a really strong lobbying component, which is all the operators. Spectrum is everything for that. So, all those complaints went into the FCC. So I go down and I walk into a meeting. There is six of the FCC chiefs, these division heads, and each of them had a lawyer behind. They come out. Luckily, I had real magazines. I said, “What are you talking about? This is absolutely untrue.” And everything changed. Well they said, “Mr. Sherry, You got some very powerful enemies.” They could not figure out how they have been duped. It looked real.

*Delrahim*

Did they use the political angle to write in to the FCC as well?
Shearer

I do not know how they did it, but think of it. We are a start-up. We are all in. All of our money is in the product that we have to build to get to all these things. What happened was they said, “Mr. Sherry, you should bring in a lawyer next time.” I said, “Can you recommend one?” and they actually did. They told me this is who you need to work with us. They realized they really had been duped. What ended up happening was, they said, “Okay. Your Christmas tree is actually tough. We’re going to use that as press that the distance between where your transmitter and the edge of the tree is the same thing as a laptop computer for the Wi-Fi transmitter.” So, that is how I got it. But look, what it did was a small company.

Delrahim

They could have shut you down.

Shearer

They did, because all our money was in. This was 2008, and investors were really easy to find in 2008.

Delrahim

More importantly, when you are trying to find a market is spooking your customers. So, Phillips is not going to mess around some illegal product that the FCC violates because they are just not going to do that.

Shearer

Kind of went off on a real tangent, but it was a real story of what you just said.

Coker [inaudible question]

Delrahim

Hopefully you’re starting with something that is at least moral from a public health and whatever standpoint, because there’s obviously things that are as legal that some people would consider are immoral, where the greatest technological innovations has happened, which is over the internet and that happens to be pornography. If you ask any web developers, some of the best audio-visual technology and online streaming has happened was done because the demand for that as well as broadband demand. Napster had a whole bunch of oth-
ers. There was Napster, there was MP3.com out of San Diego, there was Nutella out of Berkeley—this guy, who unfortunately, after they were shut down, committed suicide. There was a slew of these. If anybody has studied the copyright code, and I was involved Digital Millennium Copyright Act,21 on the staff of the Judiciary Committee, so I guess I am part of the problem. If you look at the Copyright Act, it is probably one of the most complicated, complex, special interest pieces of legislation that is almost offensive because one of my biggest pet peeves was that copies for songs for music—sound recording—if you write something, I guess even audio visuals as well, you’re not even the author. The record label is considered the author. In patent law, your employer at least gets statutory assignment of some patents or you would have that. At least you are the inventor. If you are the author of something, you are not even called the author. EMI is the author. Sony is the author. That is just because the artist, ‘til this day, have any representation in Washington. The Recording Industry Association does. The political power that they had to shut down, that we held the first hearing on Napster—that was the one where Lars Ulrich Metallica and bunch of other folks testified, and it was a big spectacle because obviously it was a very popular thing before they got shut down. It was a real issue. You are taking property rights away and the theft. The music industry has changed, but has never really recovered from that disruption. They were at fault for that disruption, but it has never recovered. The issue of the theft of property is a significant one. It is something where that combined with the political lobbying power and fundraising power that the recording industry can do in Washington is a perfectly justifiable position to take, if you are a politician. That means, you know, no technology that is going to go in. If it was not for Apple and Steve Jobs, and doing the licensing that he did, we probably still would not have the online industry that we do. We would have had more piracy than we do today, but we would not have had legitimate stores we had. Those are all licensed. There is only really three companies in the music industry. There are three labels. Everybody else is merged. I will give you another practical example. A company called Lala. They had basically come up with a new system for storing your music in the cloud. It is as if you guys had iTunes now, it is the thing you pay twenty dollars a year for that service. It recognizes your music, but its really not making direct copies, but it keeps it in the store, and it gives you free iTunes radio. That company was trying to get onto the market. Sell a subscription service for 2 dollars a month to basically create a locker of your music. Think of how much more convenient that is. No matter where you are, and as long as you have the music, it will recognize the copy, put a digitally mastered copy in the cloud for you, and you just have access to it as long as you pay your subscription service. You can have it no matter what device you go on, as long as you log in to your iTunes. The company raised a ton of money from venture capital. The three labels said “No. We want you to charge ten dollars per

21 http://www.copyright.gov/reports/studies/dmca/dmca_executive.html
month. A hundred twenty bucks a year.” And they said look “The consumer demand’s not going to be there.” They shut down. Apple bought them for pennies. Then it took them about six years to go to the labels that they have partnership with to get the licenses just to do that. It is a huge moneymaker. That was just a silly move by three labels, but it took a company with the largest capitalization in the world to have the negotiating leverage to negotiate to bring you guys something that is so convenient. I love it. It is the best deal for two bucks a month you can find. That is another example relatively within the last ten years of a technology that could not make it because you could not get the license rights. Had they gone illegally, they would have been shut down. It is that simple.

Syverson

So is the entrenched interest waging war against the insurgence. It’s been happening for so long. It is interesting. I read a book about a year ago, essentially on the founding of the film industry in Los Angeles here. The same sort of battles were going on. The two reasons why the film industry moved here from New Jersey and New York was you can shoot everyday—you can shoot in sunlight—but also because Thomas Edison had a monopoly on the cameras. Very interesting reading about hundred years ago, when the movie studios had to withstand dozens of lawsuits filed by Thomas Edison for patent infringements. It is interesting to have a perspective like that and just understand that. Again, I am a litigator, so I am coming from this perspective. Litigation is part of doing business. It is really just a component that has to be dealt with. It is unavoidable. If you are new insurgent, you are going to have enemies that are going to protect their market share. If you are the insurgent, particularly in this day in age, users are everything. You do not have to make money anymore. You do not have to make a penny as long as you got five, ten million users. You are good. There is so much money you cannot believe it in Silicon Valley. It is incredibly cheap. It’s just sloshing around up there. I was talking to one friend of mine who was a prior client. He is a calm young Stanford hot shot because that seems to be where they all come from, and the ones I know. He said “Anyone can go get a million bucks today. You just have to have the story. You don’t even have to have anything that works, just as long as you have a good story.” If you are the insurgent and you can find the money, litigation takes a long time—that’s another thing to understand. Most of you are law students, as was I fifteen years ago. When I was a law student, I did not really realize how slowly the law moves, and that’s a lot of what we are talking about here. Technology moves so fast these days. So, you have got a lot of statutes being applied to new technologies that really should not, but also to bring it back to regulators, you cannot last regulators. If you are Uber, you cannot last Garcetti. Garcetti brought an action in San Francisco and LA. The mayors have brought an action against Uber. You cannot last politicians. You
can get a complicated case kicking around state court longer than federal court
for a good couple of years. You can go up and down the appellate court. It
might be a good decade—ten years from now. What is going to happen ten
years from now? The game can totally be changed. Your enemies might be
gone. You can win a game of attrition if you are an insurgent because technol-
ygy changes so fast. As long you stay in the ball game in the courts from a litiga-
tor’s perspective, you might be okay. It does not always work out. Ariel was a
good example of someone who flamed out. You have a pretty good chance.

Koopman

In the case of Uber, you are right about that. You can definitely outlast
your competitors. A lot of times you can just exhaust a regulator to eventually
give up. The D.C.T.C., for example, came out guns blazing against Uber when
Uber came to D.C. Their goal after a matter of months was not how do we stop
Uber, but it was how do we get ourselves out of this. They had gotten them-
selves in a P.R. mess. In Pennsylvania, Virginia, and Maryland, [Uber] started a
hashtag—#UberforVA [Virginia]. In a matter of days, you have people calling
the Commissioner of the Department of Motor Vehicles in Virginia saying
“Why are you banning Uber?” You can only take so much of that pressure be-
fore you eventually flip. Essentially, what they [regulators] are mostly respond-
ing to is political pressure. In terms of outlasting competitors, look at the price
of a medallion now in New York City. Uber is just fighting tooth and nail with
the regulator, and they are outlasting them, and saying you cannot stop us. Even
when they’re banned in a state or a city, they agree to pay the fines for the driv-
ers when they get fined, and they say “we’re just willing to take that hit in the
short term” because they think they’ll survive and succeed in the long term. The
price of a medallion shoots up in the million dollars over time, but the price is
free fall in New York City. The price of a New York City medallion is a frac-
tions of what it was even eight months ago or a year ago.

Syverson

It is interesting talking to— I travel a lot—to the taxi drivers in different
cities. I ask them all the same question. How long before you switch over to
Ubers. “I’ll ride it out for a couple of more months.”

Koopman

This week I saw an article. I cannot remember what blog it was. Uber
drivers now outnumber taxi drivers in the city of New York. New York, essen-
tially a sea of yellow, and now Uber has overtaken them [taxis] as the primary
provider of local transportation in the city of New York.
Syverson

You make more than a first year lawyer as an Uber driver now. I am not kidding. That is true. They make a lot more.

Koopman

But one thing to remember when you talk about Uber is Uber is not one thing. Uber is a network of hundreds of thousands of drivers. Each of these drivers are independent of one another, and they are all using the Uber platform to connect to riders. Uber really is just a platform market. With all of these drivers and riders coming together to transact with another. If you talk to Uber Black drivers about UberX, or I think in some cities now they have UberLux. If you want a car seat, if you want an SUV with a car seat . . . Actually for a while, Uber was providing a service I think I saw in D.C. on a limited basis, drivers who were actually certified childcare types, they would drive your child to school and back. So you would know the person driving your child to come pick them up for school. You even see the UberBlack drivers saying, “Well we all have commercial licenses, but UberX drivers don’t.” You even see the infighting among the drivers in Uber. This really just highlights the fact that this is just pure protectionism in terms of taxis fighting with Uber, and Uber fighting with itself, in terms of its drivers, over who should or should not provide transportation services for people locally. Here’s a big issue, I don’t know if you guys have been following and can speak more to it than I can, but the whole idea is an Uber driver is an employee? California is where it is being hashed out right now. That is the next big fight. Is the Uber driver an employee? Uber’s ability to sidestep that question for a very long time has been a major reason why they could grow as fast as they could with the limited amount of [overhead] cost that they have had. There was little overhead for Uber, but I think that is a major issue now especially in the sharing economy and in a lot of these services. Is someone driving for TaskRabbit, are they a contractor or an employee?

Delrahim

Thumbtack. That decision in the courts here is going to have a huge impact on all of those sharing economy companies. Thumbtack, which got a hundred million dollars from Google ventures and Sequoia, they are growing like crazy. Incredible company. They provide services for home improvements. You need an electrician or a plumber, they send you licensed, legitimate folks. Their business model is really interesting. They are going to be affected. In a state like California, the political system is such that you are never going to overturn a legislative act in Sacramento that goes against the labor unions. Alabama, and even Wisconsin nowadays, it will probably be thirty five state, somebody like Uber, or others, can get a legislative change to address it based on de-
cent basic public policy, as long as they’re insured, as long as they waive away and sign saying that I’m not an employee. California, good luck. Sacramento’s bond sold by the labor unions.

[question from the audience]

There are some provisions that say lawyers shall not knowingly counsel clients things that are known to be illegal. How does that play into the advice we give when there is a regulatory scheme that is violated by a start up?

Delrahim

Well depends on what you are trying to do. Obviously I would never advise a client to sell meth on PCH. Of course, you got to tell them if it is a clear violations. You tell them you are going to go to jail doing this. That is about it. That ends a conversation. Two other technology examples: Tustin.tv and Youstream.tv. Silicon Valley backed venture companies who I am trying to shut down. We were able to negotiate settle, at least, for my clients, UFC and Major League Baseball. They are a streaming technology that will take any live event. So UFC’s more than fifty-five percent of their business is based on pay-per-view. So, you pay fifty-five bucks, sixty bucks, to beat the heck out of each other. It is real money. People are not downloading like they would with the a movie or a song. This is live. This is happening right now. You know what, half an hour from now, that thing has no value. I cannot watch Ronda Rousey beat the woman she beat two weeks ago at the Staple center more than once. Who cares? I already know the outcome. How many times are you going to watch the Super Bowl from two years ago? Once. The economic impact is different. These technology companies, they stream it so you are technically not downloading. You are not distributing. You are not duplicating. Your computer is watching it and it is going away. The impact it is having, we find that in a pay-per-view event, about two to three hundred thousand streams of illegal streams going on. Now we shut them down as fast as we can with a team in India and Boston and San Francisco, as well as our internal team that sits there and takes the DMCA notices. The DMCA, the Digital Millennium Copyright Act, says you must expeditiously take down an infringing work of art once you get notice. Well expeditiously, what the heck does that mean? It is a Saturday night event. We took it Monday 8 am first thing. That thing is going on. It is a real challenge. This is worth several hundred of million dollars of revenue, assuming all those people would pay for the product. What do you do with that? They got great counsel. Those guys do not mess around. They were advised to go ahead and do it because they make the argument that the streaming is not a download and it is not a copyright infringement. I would make the argument that violates the criminal violations of the copyright code. We brought a case—all those in the Super Bowl eight years ago—we did that with the FBI and
homeland security’s IPR center. You do as many avenues of self-help as you can, but those companies, good lawyers can make decent arguments where law is not totally clear.

[question from the audience]

But after enough decision of this sort, one could argue that they know and you were talking about the counsel that was given saying that was obviously wrong. My next question is you have a disciplinary proceeding, what is the agency that you can persuade down? If the lawyer knew.

Syverson

Nobody is ever going to make a bar complaint on that.

Koopman

I think that goes back to the whole idea that essentially the bar association is lawyers regulating themselves? From an antitrust perspective you look at the recent opinion from the Supreme Court in North Carolina Dental. What does that do to something like a bar association where the Supreme Court says if you have a controlling number of members of the licensing board that are made up of regulated members of the profession and they aren’t adequately supervised by some government actor, in a lot of ways they are not exempt from the state action doctrine. The North Carolina dental board sends a cease and desist letter. These are innovators running into regulatory issues. Teeth whiteners. You can go to the mall and get their teeth whitened. The North Carolina board of dental practitioners, or whatever it is called, they did not like that so much. Essentially the Supreme Court said you are not immune by the state action doctrine.

Delrahim

If you practice or study antitrust law, they are all lawyer cases. There is a bar association in Arizona. All of these cases that are famous for some of the precedents that you apply to every industry, lawyers have done it.

Koopman

In getting back to your initial question. I think there is a spectrum. I think there are things that are clearly illegal. You are probably walking a really fine line in consulting a client on how to undertake that activity.
[symposium attendee]

There are consequences to do that. We are not advising you to do it but this would be the consequence.

Koopman

Yeah but there is issue that is building off of the DraftKings.22 You have the guys from Intrade. Intrade shut down so one of them started a new thing called Tradesports.23 It is starting. It is building. He has basically created a futures markets in sports. They are not gambling. They are buying and selling stocks.

Delrahim

There is Fantex—there is another one, until they get shut down.

Koopman

Now they are building out. I think they just did it with the Bachelor season finale. You can buy shares of—

Delrahim

Futures contract.

Koopman

Yeah. That is [futures contract] in the contestants in the Bachelor. In real time. The value is changing with a hundred being the highest. The stock could go zero, which mean it [the outcome] is not going to happen.

Syverson

But keep in mind that there is not millions of lawyers in America because the laws are clear. You understand the point. Getting back to your original question, if you are helping someone, that is one thing. If you’re giving advice on a cutting edge technology, no lawyer is going to get in trouble for . . . well they might get sued for malpractice, which is why I would never get in the ball game in rendering opinion letters. I think you are just buying liability. I am

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22 https://www.draftkings.com/
23 https://www.tradesports.com/
not going to ensure someone’s start-up business. That aside as a practical matter, I do not think is an issue.

Shearer

As an entrepreneur, one thing I always do which is really painful, but I am doing my original budget and how I am getting my useful funds. For some reason, I always have to have these two lines. One is for legal protection from business standpoint, and one is for IP protection because I do stuff with patents. It just kills me.

Syverson

Patents are another discussion. What is going on regarding patents and digital revolution, you are going to see some really interesting stuff happening within the next ten years. I think it will be good for innovation. I do not think it will be so good for patents holders, or those seeking patents for particularly digital products.

Koopman

I was just going to add on that I think it’s important to keep in mind what the role of the entrepreneur is in the market. They are finding arbitrage opportunity, which is Peter Teal’s “zero to one move.” We can work really hard on faster horses and horseshoes and all the things to make riding horses better—or we can make a car. We can work on making more efficient type writers, or a word processor. In a lot of the technological innovation that is going on today, there are actually end-runs around really inefficient regulations. A lot of times, an industry is moving on the same margin again and again and again, until they hit the edge of where they can go with their innovations. Someone says why do we not just sidestep the barriers keeping us from moving along this margin, and just continue to innovate on that front. I think that is just a lot of times why you see this sort of creative destruction is not a clean process—it is messy. I think the people being out-innovated are ultimately going to fight tooth and nail, be it in the courts or regulatory agencies, or trying to pass laws—they’re going to fight again and again to protect themselves from those are finding new, better, more efficient ways to provide services to people who need them.

Shearer

I think there is another practical way the problem is being solved, and that is why you have these large technology companies, they have extremely active M&A activity. Or they are funding through their venture funds with the innovation they acquire but it is cheaper for them to do it outside as opposed to
inside. I was just at the corporate venturing conference and that is how they are getting the innovation. They are actually acquiring the companies that they would have fought.

Koopman

I heard Carl Schramm talk recently and he was saying that a lot of innovation right now is not always the small independent start-up. A lot of this is internal innovation. Places like Google, and things like that, allowing people to innovate. He said that an interesting thing he has been seeing is from a lot of the independent innovators coming up with these ideas. The whole point he is seeing is the decline of a trend. Steve Jobs was not interested in selling apple. Steve Jobs was interested in the perfection of his craft. He says "A lot of times today, they want to go from idea to exit. They want to get out as fast as they can, and not continue to push the bounds." I think that’s sort of changing the way people are thinking about the way they innovate. In a lot of ways, to a certain degree, some of these guys, they don’t care if it’s ultimately running complete afoul of regulations because their idea is “I’m going to be long gone by the time someone else has to deal with this issue, and I’ve sold this idea. I’ve been bought out by a larger player and that’s it for me.” I think they have a very short-term or a short-sided view of the life cycle of their company.

Syverson

Work for Pete Carroll and you will see right? Except for that last call.

Coker

We only have few minutes left and I wanted to make sure that there was enough Q&A regarding any questions specifically for any our panelist. We have a related but different value of experience. So, if anyone has question, this is your time now.

[symposium attendee]

From a legal aspect, what are some of the resources that are most helpful to you to try and keep up with everything, technology wise or innovation wise?

Delrahim

You got to have some intellectual curiosity. Going to consumer electronics show is something I used to go to. In private practice I continued to go. You kind of check things out. Some of it you’ll find that you don’t have a
whole heck of a time to—when you’re in private practice—to do things outside of an area that you have client. The best of all worlds is if you have clients and your work in the area where you are intellectually curious. It forces you to stay on top of it. I have kind of lost track of background that I had in the medical device and pharmaceutical area. So, I do not know what the latest diabetes innovation is. Within the media and technology and telecommunications side, I seem to think that I am usually here about problem based on new technological developments from clients and I stay in touch. That is what I do.

Syverson

Legally, there is two things that are part of my ritual as a litigator. I am not a techie. I do not like new products. Frankly, I do not look at my phone on the weekend. I can care less. I do not want to play video games. The Daily Journal, which is the daily legal newspaper in California, it has a daily must read for me. It has got all the appellate cases in there, all the important trial updates. It is just a great publication in my opinion, and I am not paid to say that. There is a law professor at Santa Clara who does, in my opinion, the best legal blog by far regarding tech cases. His name is Eric Goldman. He just does bang up job. Those two are my two sources.

Delrahim

He has a certain point of view, by the way, that if you like copyrights and property rights, you would not agree with. But he is a great scholar, he is incredibly prolific, and he is phenomenal on these issues. Professor Mark Lemley at Stanford is incredible on the patent side of the same type of issues, whereas Professor Goldman focuses on copyright issues.

Syverson

Goldman seems to think—and I am a litigator and I still read—he seems to thin litigation is useless and pointless. Not in agreement with him there. There is a point of view. Anyway, he is on top of the cool cases.

[inaudible question from the audience]

Delrahim

Good question. In litigation, no. Gambling is a little different. I will handle them differently. On the copyrights, no. So, they have gone to websites where they can reach. There’s a join center between FBI and Homeland Security’s ICE—Immigration and Customs Enforcement, the cop’s division of Homeland. They have centers in London, in Brussels, and in Asia. We work closely
with them to bring them information about sites, servers, where we identify on
the self-help side. We feed it to them. There is a partnership on the content side
that we work with them closely. As a coalition, I represent specifically the UFC
and the MBA. We have the coalition of the major league here and abroad. Eve-
rybody pools the information, and we work with Homeland, and they try to go
after them, but not in a lawsuit. They have gone in through their counterparts
and say, “This is an illegal site. This violates our laws.” They just use enforce-
ments to shut it down. We also go through the search engines. There is other
ways of cutting down access. We are not shutting down the website, but cutting
down access to the websites. It always is a whack-a-mole. On the gambling
side, it is different. Streaming and fantasy sports, no, nobody has gone after
them. The poker sites, there was major litigation in the justice department that
shut down full tilt. The poker sites, any of you that might have money in those
accounts, hopefully you got them back. They are trying to get back in the Unit-
ed States. They were bought by Blackstone—one of our larger private equity
firms out in New York. They make about a billion dollars a year. They were
bought for 4.8 billion. So, they are spending all the kinds of money to get back
in. But they were shut down for money laundering, for not keeping up with the
player’s accounts, and all of that. They were not shut down for the Wire Act,
for example. They were shut down for some state laws that piggybacked off of
that 2006 law that I mentioned. They were shut down for violations of multiple
laws, but not for the Wire Act. Not for the actual online gambling provision.
Partly because the precedents are not there, and if you are the U.S. attorney, or
the head of the criminal division of justice, you are a little cautious about creat-
ing bad precedent.

Coker

I want to ask just generally for those of you have experience in the start
ups, if you’re the business perspective and you have an idea which you know
might fall in this category, when do you make your first steps? Is it better to be
cautious and try to do this in different way, or knowing all of this, charge and
ready, aim, and fire sort of thing? What is the way to go?

Shearer

I would proceed in a way where it is a given you know what you are
walking into. There is no straight answer because it depends on what levels.
For instance, the wireless power idea. I knew it worked, but often, there is no
way I am going to go change the FCC regulations. That would have been the
only way in.
Delrahim

With enough money, you can do that by the way.

Shearer

That’s why my other point I made earlier today, if you know you’re going to have to sink in to that level, you better partner with one of the guerrillas that buys into your idea. That is the only way to do it. It is a given. Figure out how would you do it. For instance, I could not have started that company in the U.K. because the laws there are different. Here in the U.S., if I am not doing anything with the content that is going to the spectrum, I can own the energy in that carrier way. In the U.K., it is the antenna. It is not the content. So now I get charged by the antenna. So antenna takes carrier and content. It is a whole different thing. You have to look at all the different regulations in all the countries if you are doing a play like that. It is a long answer to that they say. No, if you know a path to get there, whether it is by a quit exit, or you can align with someone, or if you can figure out how to fund a regulatory change, if you got enough money, do it.

Delrahim

You factor that in with your VCS I think. I think it is just almost silly to not have regulatory and political risk element to what you are doing. Just like you’d hire a lawyer to draft your licensing agreement or your contract, it’s an area that people who don’t think about it, because you just assume the government is in the public interest and the right idea will prevail, well except for those students who took my class, no one will ever make that mistake, because you better have that as your component of your business.

Koopman

I think that those approaches make sense, especially if you are operating in an area that is already heavily regulated, like gambling or energy. There is clearly a lot of regulations and a regulatory body. There are pages of codes and regulations that deal with your industry. To use a different example, Haystack24 or MonkeyParking.25 There are these guys in Baltimore who were complaining about never finding a parking spot. So they came up with an app where basically I’m leaving my parking spot and I would go on my phone and say I’m leaving now, someone else who is coming would agree to take my spot if I agree to save it for them. They pay like five dollars, or something, to save the spot.

24 http://www.haystackmobile.com/
25 http://www.monkeyparking.co/
The app takes a dollar or something like this. They grew really fast in Baltimore. People in Baltimore loved it. The city council did not like it. Same thing happened in L.A. One of the city councilmen for Los Angeles said, “Could you imagine if someone in their fleet of cars took every parking spot around the Staples Center, and held them in a bidding war and basically privatize public parking.” That might make sense if there is someone who has a fleet of cars and excess times, and they want to make one dollar extra per parking spot. The cost of doing that versus the actual benefits they would get is mind-boggling. What these guys had to do was go on a public interest campaign. They went from city council to city council to educate these folks on what it is their app actually does and how it would work and the benefits it would bring to the community. Ultimately, I think, they are only operating in San Francisco, and somewhere else, and they are only using driveways and private parking spots now.

Delrahim

The moral of that story is if you are in an unregulated area, and you start getting successful; count on the government regulating you.

Koopman

It’s the same thing with Google cars. Google descended on the capital with their autonomous vehicle to get these folks [Congressman] on their side before they had to fight these things. Sort of winning them over before you have to fight your way out of the situation. I think it’s really difficult for a lot of these people, especially in the sharing economy and a lot of these technological innovations that are operating outside the area people have ever thought to regulate before. How do you get yourself in a position where someone won’t wake up one morning and say that your thing is banned forever? I think it is a difficult place to find yourself. It is outside of legal. Some of this is broader strategy in terms of developing your business plan and your P.R.

Delrahim

It happens every single day and five times a day on Wednesdays. It is part of smart business that do that all the time. The copyright code is a perfect example of where things are protected against other people’s interests. You have different interests. Music is publishers, sound recordings, there is labels, there is artist, and there is radio stations. Everybody has got a little trade association. We created half a dozen of them a year. To put people, band them together in interest strategically to get something done. A lot of times it is to protect a monopoly. Our former dean, who incredibly ably took to the Supreme Court and won in the Granholm decision on behalf of the independent wine sellers. In a couple of different roles in the government I had, we dealt directly
on that issue. One, we passed legislation to amend a certain law, to allow state
A.G.’s to go to federal court, to block anybody who, over the internet, violate a
state’s alcohol law. Then later at the justice department, I headed up the appel-
late for the antitrust division. There is a deputy in there, and Dean Starr and I
would talk. He wanted to get the antitrust division to file an amicus brief in the
Supreme Court, which made a lot of sense. In all normal situations, we would
have, except for the Wine and Spirit Wholesalers Association—later my cli-
ent—had such incredible power. These are the middle guys. This is John
McCain’s wife. Budweiser distribution. These are perfectly sanction monopo-
lies. The distributors want to perpetuate the current system, and they do not
want Internet over the top sales. They went high enough levels where the justice
department backed down from the volunteering an amicus brief in the court. In
that case, the wine and spirit folks did not do a good job. Judge Starr and Kirk-
land and Ellis, his firm, went and got seven Nobel laureate economists and
wrote a brief at the Supreme Court, which was brilliant because they made a
public policy argument based on economics but have nothing to do with the law.
The Supreme Court was inclined and ruled 5-4 in that case to allow for interstate
shipment. Following year, I was out in private practice. Wine and spirit folks
hired me, and we did a big study where it was kind of like legal opinions. You
can have economists make arguments of why that system is actually better for
public policy. It needs to be part of that strategy, I think, to get there. If you are
a new person, if you are an entrenched company, you need to watch out all the
time and protect it. It is probably horrible to do that, but that is just part of busi-
ness.

Coker

Well looks like we are about out of time, so I would like to thank our
panelists. Thank you all.